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CLIENT ALERT

Emerging Financial Crime and Legal Risks Arising from Evasion of U.S. Tariffs

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Businesses will be aware that the Trump Administration has recently announced the imposition of tariffs as a means to reduce trade deficits and incentivise the return of manufacturing to the United States. In summary, tariffs are taxes imposed by governments on imported goods when they cross a country's border, and are typically based on the specific product and their country of origin. Determining country of origin can be a complex process in accordance with local laws, and will depend on where and how specific goods are produced, assembled, and finished.

Whilst the dust is yet to settle on what the final tariff rates for each country will be, some of the country-based tariffs, such as for China, have gone as high as 145% in recent weeks. Consequently, there may be a strong incentive for manufacturers and exporters to avoid U.S. tariffs (and any reciprocal tariffs by jurisdictions subject to U.S. tariffs), including by re-classifying the country of origin, misclassifying goods, or undervaluing them.

Whilst some tariff avoidance or reduction strategies are legitimate, some could amount to tariff evasion, creating financial crime risks for any businesses with customers engaged in international trade, including in relation to:

- money laundering pursuant to the U.K. Proceeds of Crime Act 2002 ("**POCA**"); and
- facilitation of foreign tax evasion pursuant to the Criminal Finances Act 2017 ("**CFA**").

In addition, there may be further implications arising from:

- U.S. enforcement; and
- U.S. False Claims Act.

Businesses are therefore advised to ensure they stay up to date on potential red flags applicable to the evasion of tariffs, and implement robust trade-related due diligence measures to mitigate against such risks.

Money Laundering Implications under the Proceeds of Crime Act 2002

POCA is the primary legislation in the U.K. for combating money laundering and recovering the proceeds of crime. There are three primary money laundering offences under POCA which broadly criminalise the handling, or facilitating the handling by another, of criminal property.[1]

Criminal property is property which represents a person's benefit from criminal conduct, *i.e.* any conduct that constitutes an offence in any part of the U.K., or would constitute an offence if it had occurred there (provided that the offence had a maximum custodial sentence in excess of one year), even if the underlying act occurred in a foreign country and, in certain circumstances, was legal under the laws of that jurisdiction.

Evasion of U.S. tariffs, if transposed under English law, could be considered equivalent to the common law offence of cheating the public revenue or the fraudulent evasion of tax, both of which have a maximum custodial sentence significantly exceeding one year. As a result, any proceeds derived from the evasion of U.S. tariffs (*i.e.* the unpaid tariffs) would likely be classified as "criminal property" under POCA.

Any businesses providing services to or on behalf of customers engaged in international trade with the U.S. may therefore face an increased money laundering risk going forward. Customs brokers or shipping firms whose services may be used to directly evade U.S. tariffs will commit a money laundering offence when receiving payment for their services if they know or suspect their service is being so used, *i.e.* by misrepresenting the origin of goods on bills of lading.

Financial institutions providing trade finance or other financial services to businesses involved in tariff evasion may also find themselves caught up in money laundering if they know or suspect that any loans are being repaid out of

[1] §§ 327-329 Proceeds of Crime Act 2002.

the proceeds of transactions which evaded U.S. tariffs. Moreover, financial institutions operating within the regulated sector are subject to obligations to report any suspicions, or reasonable grounds for suspicion, of money laundering to the National Crime Agency ("**NCA**"), for which failure to comply is itself a criminal offence under POCA.

Facilitation of Foreign Tax Evasion Implications under the Criminal Finances Act 2017

Pursuant to the CFA,[2] a "relevant body" (*i.e.* a body corporate or partnership) can be held criminally liable if an "associated person", meaning an employee, agent, or other person performing services for or on its behalf, facilitates the commission of a "foreign tax evasion offence", provided that a U.K. nexus exists.[3] Given that the evasion of U.S. tariffs is a criminal offence under U.S. law, it is highly probable that it would be considered a "foreign tax evasion offence" for the purposes of the CFA.

Therefore, if an associated person provides services for or on behalf of a relevant body which facilitates the evasion of U.S. tariffs, for example, by misrepresenting the value, quantity, or origin of goods to avoid paying the correct duties, the relevant body would be in violation of the CFA unless it can demonstrate that it has reasonable prevention procedures in place. Such procedures would include carrying out a risk assessment, implementing proportionate procedures, ensuring top-level commitment from management, adopting due diligence measures, communicating procedures to associated persons, and monitoring and review of the above.

U.S. Tariff Enforcement

U.S. Customs and Border Protection has primary responsibility for tariff enforcement, frequently referring violations to the Department of Justice to pursue civil and criminal penalties. The False Claims Act ("**FCA**") has been a traditional means to enforce tariff evasion, which we discuss in greater detail below. However, the invocation of the International Emergency Economic Powers Act ("**IEEPA**") to impose "reciprocal" tariffs and new duties on Canada, China, and Mexico have opened the possibility for the United States to enforce these tariffs through new means. Violations of IEEPA, which can be enforced on a strict liability basis, carry a baseline civil penalty of $250,000 or twice the amount of the violative transaction, whichever is greater.[4] Moreover, willful violations of IEEPA are subject to criminal enforcement, with penalties up to $1 million or up to 20 years in prison.[5] While the use of IEEPA to impose tariffs raises the specter of weightier enforcement mechanisms, statements from Justice Department officials at this stage indicate they will continue to use the FCA to respond to potential tariff evasion.

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2 § 47 Criminal Finances Act 2017.

3 Including where (1) the relevant body is incorporated or formed under the law of the U.K.; (2) the relevant body carries on at least part of its business in the U.K.; or (3) any act constituting part of the foreign tax evasion offence takes place within the U.K.

4 50 U.S.C. § 1705(b).

5 *Id.* at § 1705(c).

U.S. False Claims Act

Although FCA cases have historically focused on alleged false claims involving entities contracting with the U.S. government for healthcare or defence-related products and services, recent Executive Orders as well as statements by U.S. Department of Justice ("**DOJ**") officials suggest that the DOJ is likely to use the FCA to "aggressively"[6] target compliance with customs and tariffs and that such enforcement will target a broader range of industries and businesses than it has historically.

The FCA prohibits, among other things, knowingly and improperly avoiding or decreasing an obligation to pay monies to the U.S. government.[7] "False" is not expressly defined in the statute but has been interpreted to apply to claims that are expressly false (*e.g.* misrepresenting specific facts), impliedly false (*e.g.* misrepresenting compliance with government rules and regulations), or are otherwise based on a false record. Both DOJ and whistleblowers (referred to as "relators") who file suits on behalf of the government ("*qui tam*" suits) have successfully brought claims based on alleged customs duty or tariff avoidance as such "obligations". These are often described as "reverse" false claims, where the theory is that the company was required to return the monies to the government and knowingly or recklessly failed to do so. In terms of the types of conduct giving rise to such claims, recent cases have alleged:

- understating the value of the goods to Customs and Border Protection to avoid paying the full amount of customs duty owed;[8]
- mislabelling or improperly classifying goods to enter the U.S. to move them to a lower tariff classification or to avoid a tariff altogether, resulting in an underpayment of customs duties;[9] and
- misrepresenting the country of origin for imported items.[10]

The FCA also creates liability for those who conspire to violate the FCA.[11] Consequently, other businesses in the import or export chain that are not themselves responsible for paying customs duties may still face enforcement risk under a conspiracy theory.

Given the focus on tariffs and on the FCA as an enforcement tool for tariffs, combined with the FCA's *qui tam* provisions (which allow relators to receive up to 30% of any recovery plus attorneys' fees), we expect increased scrutiny in this area and increased investigations of customs-related FCA cases.

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6 *See* https://www.law360.com/articles/2300751/doj-official-flags-aggressive-fca-approach-under-trump

7 31 U.S.C. § 3729(a)(1)(G).

8 *See* https://www.justice.gov/usao-sdfl/pr/us-attorney-lapointe-announces-76-million-settlement-civil-false-claims-act-lawsuit.

9 *See* https://www.justice.gov/usao-nj/pr/owner-new-jersey-company-admits-evading-us-customs-duties-and-his-company-agrees-31; https://www.justice.gov/usao-sdny/pr/us-attorney-announces-228-million-settlement-civil-fraud-lawsuit-against-vitamin.

10 *See* https://www.justice.gov/opa/pr/evolutions-flooring-inc-and-its-owners-pay-81-million-settle-false-claims-act-allegations.

11 31 U.S.C. § 3729(a)(1)(C), (G).

Practical Guidance for Businesses

To effectively navigate the risks associated with U.S. tariff evasion by customers engaged in international trade, businesses should be vigilant for the presence of red flag indicators that may suggest a customer is involved in evasion of tariffs. Many of these indicators are also applicable to the circumvention of sanctions, tax evasion, money laundering and fraud, highlighting the close relationship between these forms of financial crime, including:

a. unusual shipping routes or transshipment points;

b. significant discrepancies between the declared value of goods and their prevailing market prices;

c. vague or incomplete descriptions of goods on trade-related documents;

d. the use of shell companies or complex ownership structures without any apparent legitimate business rationale; and

e. sudden or unexplained changes in established trading patterns or the identity of counterparties.

In order to identify these red flag indicators, and as part of a programme of "reasonable prevention procedures" for the purposes of the CFA and consistent with compliance best practices, impacted companies should consider implementing a robust framework of due diligence measures. These may include, but are not limited to:

a. conducting enhanced customer due diligence on clients involved in international trade, especially those with dealings with the U.S., to gain a thorough understanding of their business operations, supply chain intricacies, and overall trading activities;

b. implementing transaction monitoring systems to identify any unusual or suspicious patterns, such as inconsistencies in pricing, significant variations in volume, or deviations from established trade routes (*i.e.* new ports of call); and

c. reviewing the terms of contractual relationships with customers and business partners to ensure appropriate risk allocation and undertakings regarding compliance with applicable trade and customs laws and obligations.

Clients may also wish to review compliance training as relevant to these emerging risks as well as ensure that employees are familiar with how to report concerns regarding these issues.

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